NATIONAL CREDIT UNION ADMINISTRATION

NCUA News

May 1999, Number 3

BOARD ACTIONS - MAY 3, 1999

Prompt Corrective Action Proposal Sets Capital Standards for Credit Unions

The NCUA Board voted unanimously May 3, 1999, to issue, for a 90-day comment period, proposed rule Part 702 implementing a system of prompt corrective action pertaining to capital levels for federally-insured credit unions.

The *Credit Union Membership Access Act* to (CUMAA) requires the NCUA Board to adopt a system of prompt corrective action indexed to the five capital categories established by CUMAA. The purpose of this system is to minimize long-term losses to the NCUSIF caused by inadequately capitalized credit unions. Congress requires that NCUA's system of prompt corrective action to be "comparable" to the system Congress established for banks in 1991.

Although CUMAA prescribed much of the prompt corrective action system, Congress gave NCUA the responsibility to develop certain components uniquely suited to credit unions, including —

- discretionary supervisory actions to supplement the mandatory actions prescribed by CUMAA;
- an alternative system of prompt corrective action for credit unions that meet CUMAA's definition of "new";
- contents and criteria for approval of Net Worth Restoration Plans and deadlines for submission and decision of such plans; and
- a "risk-based net worth requirement" to apply to "well capitalized" and "adequately capitalized" credit unions that NCUA defines as "complex."

Proposed Part 702 establishes regulations implementing a comprehensive system of prompt corrective action for federally-insured credit unions. Specifically, the rule—

- establishes a five-tiered capital structure based on net worth ratios set by CUMAA;
- adopts the mandatory supervisory actions and conditions for conservatorship and liquidation prescribed by CUMAA;
- establishes a series of progressively more stringent discretionary supervisory ac-

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Y2K Testimony

Excerpts from Chairman Norman E. D'Amours' testimony before the House Banking Committee April 13, 1999, on NCUA and federal credit union Year 2000 remediation.

NCUA has completed its internal Y2K preparations. We have repaired, tested and verified all of our internally developed and maintained systems. End user tests of our systems were completed in the summer and fall of 1998 and the tests confirmed that all production systems are Y2K ready.

A total 10,483 credit unions—95% of all federally insured, natural person credit unions—met NCUA's January 31, 1999, deadline for completion of Y2K renovation of mission critical systems.

Thirty-five of the 38 corporate credit unions completed remediation efforts by the January 31 deadline. The three corporate credit unions not renovated were found to be progressing in a satisfactory manner and received waivers of action. These three corporates are on target to meet their next milestone date.

NCUA is engaged in intensive oversight of those credit unions that failed to meet the renovation completion deadline. The actions taken against the 515 credit unions that failed to meet the renovation completion deadline are as follows:

- 115 formal actions were put into place.
- 212 waivers were granted.
- 93 credit unions were placed under closer supervision and had completed renovations by March 31, 1999.
- 25 credit unions were in the process of merging, liquidating, or converting to a new system.
- 70 credit unions have action pending and are receiving closer supervision.

Any credit union without a waiver that has not substantially implemented a Y2K-ready system by July 31, 1999, will be merged or conserved (placed into receivership) to ensure that a Y2K-ready system is in place. Any credit union without a fully implemented Y2K-ready system by September 30, 1999, will be merged or conserved to ensure that a Y2K-ready system is in place. If merger or conservatorship is not possible, the credit union will be liquidated, although we do not expect liquidations will become necessary.

While NCUA sees no need for credit union members to withdraw larger than usual amounts of cash before the Year 2000, it is possible that intense media focus on the date change will cause an increased demand for cash at the end of 1999. I repeat— there is absolutely no substantive reason to withdraw large amounts of cash.

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NCUA Board Upholds FOM Regulation

- **CLF Ceiling Raised** – On May 11, the Conference Committee on Supplemental Appropriations for Kosovo approved an amendment to eliminate the current $600 million appropriation ceiling on the Central Liquidity Facility and replace it with the ceiling in Title III of the Federal Credit Union Act, which is approximately $21 billion. The amendment, as offered by VA, HUD and Independent Agencies Subcommittee Chairman James Walsh (R, NY), would be effective for fiscal year 2000, which begins in October. The bill is expected to reach the House floor soon.

  NCUA and the credit union trade associations have been seeking to have the CLF borrowing cap lifted because of concerns that a computer glitch tied to the Year 2000 date change could result in an increased demand for liquidity. It is extremely unlikely that credit unions will face any Year 2000 conversion problems, but credit unions may face increased liquidity needs if members withdraw extra cash at year end.

- **Regulatory Relief Testimony** — NCUA General Counsel Robert Fenner testified in support of proposals to lessen regulatory burden on financial institutions before the House Financial Institution Subcommittee on May 12.

- **NCUSIF Equity Level** — The equity level of the NCUSIF increased to 1.29% for the period ending April 30, 1999. The equity level is based upon an insured share base of $322.5 billion at December 31, 1998.

- **Fair Lending** — The interagency uniform fair lending examination program is final. NCUA will train three to five examiners from each region. Each region will conduct approximately five fair lending examinations in 1999.

- **Expansions** — From January 1 to April 30, 1999, a total of 914 credit unions expanded to serve an additional 6,138 new groups offering credit union service to a potential 519,428 new members. The average group size is 84.6 people, and 153 expansion applications have been denied.

May Board Actions

- **NCUSIF Restructuring**. — Proposed changes to the National Credit Union Share Insurance Fund, as required by CUMAA, is scheduled for Board consideration on May 19. NCUA's chief financial officer will return to the Board in September or October to recommend a normal operating level for calendar year 2000. Under CUMAA, the Fund's operating level can range from 1.2 to 1.5 percent.

Disaster Assistance Activated for Oklahoma and Kansas

On May 7, 1999, NCUA activated its disaster relief policy to assist credit unions and members in Oklahoma and Kansas, where offices and homes were destroyed by multiple tornadoes.

Region V examiners and staff stayed in close contact with the affected federal credit unions to determine whether danger existed and to offer advice and assistance. Under the disaster relief policy, the NCUA will, where necessary:

1. Encourage credit unions to make loans with special terms and reduced documentation to members whose homes and property are damaged;
2. Reschedule routine examinations of affected credit unions; and
3. Guarantee lines of credit for credit unions through the National Credit Union Share Insurance Fund and the Central Liquidity Facility.

During disaster conditions, NCUA personnel operate under three priorities:

- Ensure the safety of credit union staff.
- Keep facilities and operations available to members.
- Provide material and technical assistance, as needed, to affected credit unions.

NCUA News

NCUA News is published by the National Credit Union Administration, the federal agency which supervises and insures credit unions.

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Yolanda T. Wheat, *Board Member*
Dennis Dollar, *Board Member*

Information about NCUA and its services may be secured by writing to the Office of Public and Congressional Affairs, or by calling 703-518-6300. News of what is happening at NCUA is available by calling 800-755-1030 or 703-518-6339.

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NCUA Seeks Comments on Call Report Changes

NCUA would like credit unions and the credit union community to comment on the numerous changes that we plan to implement in *September 1999 Call Reports* for credit unions over $50 million and in *December 1999 Call Reports* for all federally insured credit unions.

Although a few of the changes were initiated by NCUA, most changes were mandated by Congress in the *Credit Union Membership Access Act*. Specifically, Section 201 of this new law requires that reports filed with NCUA be consistent with generally accepted accounting principles (GAAP).

Three main areas reflect proposed changes:

- **Federal credit union (FCU) and state credit union (SCU) versions of the form are combined into a single form**. A single form will simplify programming of the PC5300s and will streamline printing and mailing procedures. Relevant questions are noted as "SCU Only" or "FCU Only."
- **Revisions to the Statements of Financial Condition and Income and Expense** comply with the GAAP reporting requirement of CUMAA. The American Institute of Certified Public Accountants (AICPA) provided comments guiding these changes.
- **New data collection** adds items to lease activity, cyber financial services, and borrowing arrangements.

Please refer to *Letter to Credit Unions 99-CU-6* for details of the specific changes. The 60-day comment period began in late April and will end in late June 1999. *Letter 99-CU-6* is available on NCUA's website at www.ncua.gov/ref/letters/letters.html. A copy can be obtained from NCUA Publications at 703-518-6340.

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tions indexed to each net worth category and designed to further the purpose of Part 702;
- sets deadlines, content, and criteria requirements for Net Worth Restoration Plans;
- creates a system of prompt corrective action for "new" credit unions — those in operation less than 10 years and with $10 million or less in assets — with relaxed net worth ratios, regulatory forbearance and incentives to build net worth;
- revises current reserve and dividend payment regulations to reflect the repeal of Section 116 of the *Federal Credit Union Act* and to conform to CUMAA; and
- establishes procedures for notice, review and enforcement of directives requiring prompt corrective action.

In developing the proposed rule, NCUA worked closely with a representative group of state credit union supervisors.

The proposed rule incorporates that group's substantial contributions as well as comments provided by the U.S. Department of the Treasury. In addition, it reflects the findings of an NCUA staff committee that has studied field experience with new credit unions over the past 10 years. Public comments received in response to the October 1998 advance notice of proposed rulemaking are also incorporated.

Congress mandated a separate timetable for implementing the "risk-based net worth requirement" for credit unions that NCUA defines as "complex," which will be the subject of a separate proposed rule. With the exception of the risk-based requirement, CUMAA requires the NCUA Board to adopt a final prompt corrective action rule by February 7, 2000, that takes effect August 7, 2000. NCUA staff expects to present a proposed rule to the NCUA Board on the risk-based requirement in late 1999. It must be finalized by August 7, 2000, and effective by January 1, 2001.

BOARD ACTIONS
APRIL 15, 1999

Flexible Charitable Contributions Rule Finalized

The Board approved final rule, Part 701.25, incorporating a long-standing policy allowing federal credit unions to, within limits, make charitable contributions and donations. Part 701.25 stipulates that a federal credit union board must approve donations and contributions and that they must be in the best interest of the credit union. The regulation allows charitable contributions to the following:

(a) Recipients not organized for profit that are located or conduct activities in a community where the federal credit union has a place of business; or

(b) Organizations that are tax exempt under Section 501(c)(3) of the Internal Revenue Code and that operate primarily to promote and develop credit unions.

The board of directors must approve charitable contributions or donations. Approval must be based on a determination that the contributions or donations are in the best interests of the federal credit union and are reasonable given the size and financial condition of the federal credit union. The board can choose to establish a budget for charitable contributions or donations and authorize appropriate officials of the federal credit union to select recipients and disburse budgeted funds.

Share Insurance Coverage Expanded, Comments Sought on Interim Final Rule

The NCUA Board adopted an interim final rule, effective immediately upon publication in the *Federal Register*, that simplifies the share insurance rule on joint ownership accounts and extends coverage on revocable trust accounts to parents and siblings of the account holder. The Board also asked for comments on additional provisions in the share insurance rule in order to consider more revisions to further update and clarify the rule.

This change in the insurance rule eliminates the two-step process for determining insurance on joint accounts and adds siblings and parents to the list of "qualifying beneficiaries" on "payable-on-death" accounts. NCUA terminology on "payable-on-death" accounts, will change from "testamentary" to "revocable trust" to conform with the term used by the FDIC and to eliminate any consumer confusion between the two federal insurance programs.

NCUA's "Your Insured Funds" brochure will be updated and redistributed.

A few examples illustrating the changes follow:

Example 1

Mr. Smith—individual account—$100,000
Mrs. Smith—individual account—$100,000
Mr. & Mrs. Smith—joint account—$200,000

Under the old rule, both individual accounts are fully insured and the joint account is insured separately, but only for $100,000. The Smiths' insurance coverage totaled $300,000, and $100,000 is uninsured.

Under the new interim final rule, the individual accounts are still insured separately, but now in the joint account NCUA looks at the interest of each joint owner. Mr. and Mrs. Smith each have $100,000 interest in the joint account; thus, each is covered for $100,000 in the joint account and all their money, $400,000 is insured through the NCUSIF.

Example 2

Mr. & Mrs. Jones have a joint account with $100,000

They have an adult child who has an individual account of $100,000. That child opens a revocable trust account naming Mr. and Mrs. Jones and a younger sibling as beneficiaries with $100,000.

The Jones' ask the credit union how much coverage they have on all their accounts and would they have more coverage if they add their two children to the joint account.

Under the old rule, the joint account would only be insured up to $100,000. Adding the two children would not increase coverage. Because the child's revocable trust account names parents and a sibling as beneficiaries, all the funds in the account are added to the child's individual account. The maximum insurance coverage is $200,000 — $100,000 for the Jones' joint account, and $100,000 total for the child's individual and revocable trust account.

Under the new interim rule, the results are quite different. Mr. and Mrs. Jones could

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Business Resumption Contingency Planning

Contingency planning is a critical part of addressing the Year 2000 issue. Execution of major projects seldom proceed exactly as planned and credit unions must not wait until problems arise to explore alternate solutions. Contingency planning is the subject of NCUA *Letters to Credit Unions 99-CU-1*, January 1999; *98-CU-12*, June 10, 1998; and *98-CU-2*, January 1998. The issue is also touched on in recently released *Letter to Credit Unions 99-CU-2*, March 1999.

Year 2000 contingency planning involves development of two plans — each addressing a different Year 2000 risk. First, credit unions need a remediation contingency plan to address the risks associated with the failure to successfully complete renovation or implementation of their Year 2000 readiness plan. Second, credit unions need a business resumption contingency plan to address the risk associated with the failure of systems at critical dates.

NCUA *Letter to Credit Unions 98-CU-2,* instructed credit unions to incorporate a remediation contingency plan into their Year 2000 readiness plan. NCUA *Letter to Credit Unions 99-CU-1*, entitled "Answers to Frequently Asked Questions about Contingency Planning," states that credit unions should substantially complete business resumption contingency planning as soon as possible and not later than June 30, 1999. Contingency plan testing may occur after June 30,1999.

Business resumption contingency plans allow credit unions to effectively prepare for identifiable potential problems. Examples of such problems include:

- failure of one or more mission critical systems,
- extraordinary liquidity (cash withdrawal) demands, or
- interruption of utilities.

Information on liquidity planning can be found in *Letter to Credit Unions 99-CU-2*, as well as several past issues of the *NCUA News*.

Credit unions should identify high risk areas and prioritize the development and testing of contingency plans based on their risk assessment.

Business resumption contingency planning includes the following four phases.

1. Establishing *Organizational Planning Guidelines* that define the business continuity strategy. This includes:
   - identifying the person responsible for developing and monitoring the Year 2000 business resumption contingency plan;
   - identifying core business processes (e.g., ACH, lending, withdrawal and deposit);
   - identifying mission critical systems (and other business processes) making up each core business process;
   - identifying internal and external business dependencies for each core business process;
   - establishing an event timeline;
   - developing a risk management process to prioritize risks and report progress; and
   - reviewing existing business continuity or contingency plans and disaster recovery plans, ensuring they address unique aspects of possible Year 2000 disruptions (e.g., power and telecommunication services).
2. Completing a *Business Impact Analysis* that assesses the potential impact of one or more mission-critical system failures. This includes:
   - performing a risk analysis of each core business process (considering the status of Year 2000 readiness renovation or replacement plans for mission-critical systems, financial and marketing impact of the loss of a core business process, and any impact on regulatory requirements);
   - defining and documenting Year 2000 failure scenarios (internal and infrastructure) — including the duration of failures; and
   - determining the minimum acceptable level of outputs and services.
3. Developing a *Contingency Plan* that establishes a timeline for implementation and action, circumstances, and trigger dates for activation. Essentially, it determines who will do what, when and where. Specifics include:
   - evaluating options and selecting the most reasonable contingency strategy;
   - identifying specific contingency plans (including specific resources that will be needed) for each core business process;
   - establishing public relations protocols;
   - reviewing network access to other systems;
   - reviewing and testing the credit union's disaster recovery site to ensure Year 2000 capability and hardware availability;
   - identifying trigger dates and personnel necessary to activate the contingency plans;
   - obtaining an independent review of the feasibility of the contingency plans by a qualified independent party if appropriate, (e.g. auditor, consultant or employee not involved in development of plans); and
   - ensuring implementation plans and availability of staff on key dates determined by management.
4. Designing a method of *Validation* for testing the viability of business resumption contingency plans. This can include:
   - simulations;
   - role play;
   - walk-throughs; and
   - alternate site reviews.

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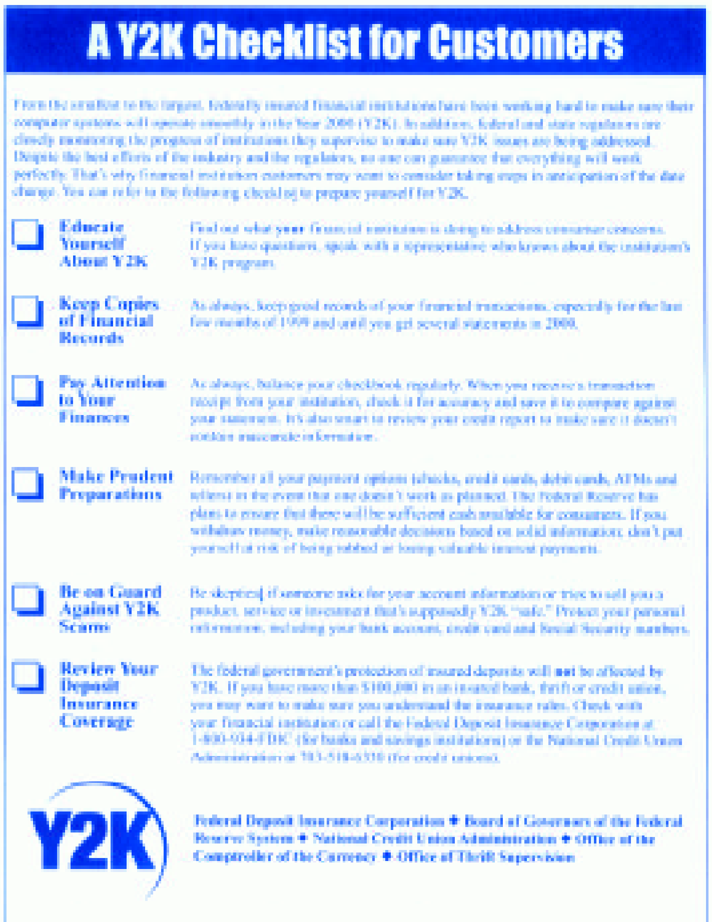
Y2K Checklist for Consumers Issued

The federal financial regulators believe that customer awareness is an important component of Year 2000 preparations. To help consumers prepare for the century date change, NCUA and fellow financial regulators have prepared a *Y2K Checklist for Customers* that NCUA released in Letter No 99-CU-8 .

Every federally insured bank, savings institution and credit union will be sent a camera-ready copy of the checklist to reprint and distribute to their customers if they wish.



A Y2K Checklist for Customers

Educate Yourself About Y2K

Keep Copies of Financial Records

Pay Attention to Your Finances

Make Prudent Preparations

Be on Guard Against Y2K Scams

Review Your Deposit Insurance Coverage

Y2K

Federal Deposit Insurance Corporation ♦ Board of Governors of the Federal Reserve System ♦ National Credit Union Administration ♦ Office of the Comptroller of the Currency ♦ Office of Thrift Supervision

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have $200,000 coverage on the joint account, and if they add their two children, coverage could increase to $400,000 — the interest of each co-owner is insured to $100,000. Also, the child's individual account would be insured up to $100,000 and, because the interim rule extends coverage on revocable trust accounts to parents and siblings, the child's revocable trust account would be insured up to $300,000 ($100,000 per beneficiary). The maximum coverage on all the accounts could be as high as $800,000.

Charter Conversion

The NCUA Board approved a community charter conversion for $116.7 million Sandia Area FCU, Albuquerque, N.M.

The conversion approval allows the credit union to convert from a multiple-group to a community charter able to serve the people who live, work, worship, or attend school and businesses and other legal entities located in Bernalillo County or the city of Rio Rancho, N.M.

ABOUT INVESTMENTS

Money for Nothing and the Risks Are Few?

Have you been offered an additional return on your investment securities? Does the phone caller offer you money for doing practically nothing? Place your investment securities in a trust and you will receive from 1 1/2 to 3 percent of the securities' market value per year in additional fee income. The caller notes this is a "unique" opportunity associated with an international banking facility's granting of credit lines to third parties. The deal is so good that you will immediately receive an "advance" equal to 1/4 of a year's fee. Plus, the trust is insured against fraud by a familiar, household-name insurance company.

What's the catch? In return for the "advance" you permit the trust to use your securities *however it wants.* The trust agreement typically permits the trust to engage in various securities transactions, including sale of your securities and use of the proceeds for any purpose, as long as you have an "advance" outstanding. There is no fraud, since you have authorized the trust to engage in this "unique" opportunity. Any credit losses on the trust's use of your securities are your losses, since the insurance only covers fraud.

The trust's activities go beyond those a federal credit union may engage in under NCUA regulation Part 703 and the *Federal Credit Union Act*. This means that the trust is not a permissible investment for a federal credit union. This example also serves as a reminder of the cliché, "If it sounds too good to be true, it is."

Y2K Business Resumption

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Credit union employee training should ensure staff can implement the credit union's Year 2000 business resumption contingency plans. Such training will enable staff to work together prioritizing core business processes and establishing critical timelines to resume operations or implement work-arounds in the event of a disruption. Employees responsible for implementation should have ready access to information on procedures for responding to Year 2000 events and operational failures.

Help NCUA Plan for the Future

The National Credit Union Administration has begun the challenging task of developing a 5-year strategic plan that will guide the agency into the 21st Century and beyond.

In support of this initiative, senior executives from NCUA have begun contacting various credit unions, trade associations, community groups, academia and others to solicit opinions about what significant challenges and opportunities the agency and the credit union system should be preparing for. Current and former NCUA Board members, and other federal agencies are also being interviewed for their insight.

While NCUA is focused on our day-to-day supervision responsibilities we must also be mindful of the long-term picture of the industry we are charged with overseeing," said NCUA Chairman Norman E. D'Amours. "Although no one knows the future, we must prepare to meet its challenges as best we can.

Examples of challenges might be technological changes, competition, and economic trends, but no one should feel constrained to limit the discussion to only these areas," noted D'Amours.

"Strategic planning is critical to the success and longevity of any business or industry," added NCUA Executive Director Carolyn Jordan. "I believe that no one better understands what obstacles and challenges lie just beyond the horizon than the individuals who deal everyday with credit union operations. I hope the organizations contacted will offer our office directors and regional directors their best judgment and frankly discuss all relevant issues," said Jordan.

Members of the Strategic Planning Committee include some top Central Office staff, Layne Bumgardner, Melinda Love, Dorothy Foster, Joyce Jackson, David Marquis, Bob Schafer, Ed Dupcak, Sherry Turpenoff and Doug Verner; and Regional Directors Jane Walters, Tawana James and Alonzo Swann.

We welcome everyone's opinion of what critical issues must be addressed to ensure a strong and effective future for NCUA and the credit union movement. Because the committee is limited in the number of personal contacts it can make, you can mail or fax your suggestions to the attention of NCUA Strategic Planning at (703) 518-6409 or transmit suggestions via e-mail to *pacamail@ncua.gov*

April 23, 1999 – Board Member Yolanda Wheat meets with members of the Gulfport VA Federal Credit Union prior to addressing the 62nd Annual Meeting and Convention of the Mississippi Credit Union System.

Mrs. Wheat focused her remarks on the short term issue facing credit unions – final Year 2000 preparations – and long term issues such as technology, consumer expectations and NCUA's strategic plan development.

Y2K Testimony

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But we all know that sometimes human actions are not based on logic, and NCUA has a responsibility to ensure that credit unions are able to deal with the threat of increased liquidity demands at the end of 1999.

In conclusion, we at NCUA are confident that credit unions will be well-positioned for the millenium date change. The vast majority have completed Y2K preparations on or ahead of NCUA's schedule. I am hopeful that the education efforts of NCUA and credit unions will reconfirm to credit union members that their financial institutions are safe, sound, and viable.

NCUA News

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